Posh Pasties – teachers' notes

Target: Year 9/10 students (3-year/2-year GCSE Business students).

Materials required: A1 paper and pens, Posh Pasties case study document. Students will need calculators.

Activity time: 40 minutes + presentation time of 5 minutes per group.

Presentation time: 5 minutes per group.

Group size: Variable. I find four randomly chosen students per group to work best.

Specification link: 1.3.4 Sources of business finance – retained profit, overdrafts, bank loans, venture capital, crowdfunding.

Differentiation/EAL/SEN:

Carefully think about which students are 'randomly selected' to form groups. Find a method of making the selection process appear random but at the same time creating groups of balanced abilities. To provide differentiation, tip/clue cards could be created of each source of finance.

Method:

Print out the 'Posh Pasties' resource on A3 paper. Give this out to each group with a sheet of A1 paper for their workings/presentation. You may also want to provide coloured pens/scissors for each group as well. Each group has 40 minutes to come up with an answer to the problem and justify it.

Skills tested:

Students are working as a team. Each group is being asked to make a judgement and analyse different pieces of information presented in an incomprehensible way. Therefore the activity tests skills at the top end of Bloom's Taxonomy.

Solution to the problem:

There is invariably no right or wrong answer. Students have to justify their choice and it may be that they place different weightings of importance on some of the factors. The following are a list of factors that students may consider in their presentations:

(i) Retained profit:

In 2016 the company made £12,000 profit which is not enough to cover the £15,000 purchase cost of the van. The company also paid out £10,000 in dividends so they only actually had £2,000 to use towards the van's purchase. Therefore, retained profit would not be suitable for the company to use if the van had to be purchased in 2016.

If the company is willing to wait, it may prove to be the cheapest source of finance, but the company is rapidly expanding so waiting may hold back the company's growth in the short term.

(ii) Bank loan:

The bank loan will provide the whole £15,000 although the company may have to produce a business plan in order to get the loan. The interest rate is 8% so the interest cost per year is £1,200. Therefore, over five years, there will be a total cost of £6,000. This cost will reduce profits and the annual interest may make cash-flow even tighter.

(iii) <u>Overdraft:</u>

The overdraft would cost £3,000 (20% x £15,000 = £3,000) in the first year, but would have a larger strain on cash-flow compared to the bank loan in the first year. This may create cash-flow problems for the company since there will be £18,000 of cash outflows during the year.

(iv) <u>Venture capital:</u>

The company is worth £200,000 and with the venture capitalist providing a further £20,000, the company would be worth £220,000. However, this would reduce James' shareholding to 54% and Holly's shareholding to 36% in order to accommodate the venture capitalists 10% share. The benefits are that there is no interest to pay and the venture capitalist provides an extra £5,000 of capital to improve the company's cash-flow above the purchase cost of the van. The venture capitalist could also provide help and advice, which could help The Posh Pasty Company Ltd to successfully expand. However, Holly and James now have a reduced ownership of the company.

(v) <u>Crowdfunding 1:</u> <u>www.crowdfunder.co.uk</u>

The four Pasty Days are worth £8,000 and the 2,000 pasties are worth £8,000 so the cost of this method is £16,000 which is cheaper compared to the loan and overdraft. This method also involves no dilution of ownership. The Pasty Days and free pasties may also be a form of marketing that will boost demand and build a reputation for The Posh Pasty Company Ltd, considering that it is growing rapidly. However, The Posh Pasty Company Ltd will have find individuals/companies who are willing to provide capital and are willing to accept this reward in exchange. This may be time-consuming/impossible to do.

(vi) <u>Crowdfunding 2:</u> <u>www.fundingcircle.co.uk</u>

This method costs £10,000 (5% of the company's 2016 value of £200,000) plus three Pasty Days which are worth £6,000. Therefore, the total cost is the same as option (v) of £16,000. The Pasty Days, again, could be a good marketing opportunity and the offer of an equity stake may make it easier to gain the full amount of crowdfunding required. The drawbacks are dilution of ownership, but this is less than what the venture capitalist required. However, the company may have to wait to generate the full £15,000 compared to the venture capital option.